



MM POSITION PAPER: MINISTERIAL DUAL STATUS EMPLOYMENT

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Application: Ordained or licensed ministers are often misunderstood employment classifications. This paper is intended to help clarify the unique nature of ministerial employment status and give practical advice on the handling of taxes.

Dual Status Filers: By IRS mandate, ordained and/or licensed ministers are required to be "dual" status tax filers. This means that clergy are treated as "employees" for benefit purposes (health insurance, retirement plans, etc.) and "self employed" for taxation purposes.

Housing Allowance: Ministers are eligible to have their expenses related to living quarters separated from their salary, and if justified with actual receipts, are allowed to reduce taxable wages for federal and state income tax. See our Annual Ministerial Housing Allowance position paper and Housing Allowance Worksheet on our website for more information. (GoodFaithAccounting.com)

Be sure the designation of a housing or parsonage allowance for the subsequent year is on the agenda of the church board for one of its final meetings of the current year. The designation should be an official action of the board or congregation, and it should be duly recorded in the minutes of the meeting. The IRS also recognizes designations included in employment contracts and budget line items - assuming in each case that the designation was duly adopted by the church board (or the congregation in a business meeting). Also, if the minister is a new hire, be sure the church designates a housing allowance prior to the date he or she begins working.

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Plan a mid-year review of the housing allowance to make sure the designated amount is sufficient to cover actual expenses. If a minister's expenses will exceed the allowance, the church may amend the allowance. But any amendment will only operate prospectively.

FICA Tax: During approximately the first year of employment as a minister, they have the right to "opt out" of the Social Security System if they can morally sign an agreement that they have "religious beliefs that prevent you from accepting government benefits from taxes paid into a government system from compensation received from a church." Most people attempt to make this decision based on the investment worthiness of the Social Security System, when in reality, it has nothing to do with rate of returns or benefits.

If a minister has chosen to opt out of the social security system, then they will not be responsible for paying in the self employed FICA payments equal to 15.3% of the salary and housing allowance. They must also understand that unless they have worked enough to qualify for Social Security coverage, they and their family will not receive retirement, disability, or supplemental death payments. (If a spouse has earned enough credits, then they and the children would receive benefits from any change in their health or life status.)

If they chose to stay in the social security system, then they will be responsible for paying 15.3% of their combined salary and housing allowance. The IRS requires quarterly payments (that do not match the calendar quarters) or they have the option of taking out extra federal withholding tax from their paychecks to compensate for the amount owed for social security.

The self employed social security tax is broken down into two parts:

OASDI – (retirement)	6.2% employee + 6.2 % employer = 12.4%
Medicare – (retirement health insurance)	1.45% employee + 1.45% employer = <u>2.9%</u>
Total	15.3%

OASDI is no longer deducted after you reach the annual limit, see IRS website for current level. Medicare has no limits.

Federal Income Tax Withholding: The IRS does not require that federal income tax withholding be deducted from minister's paychecks. Ministers are still responsible for paying federal income tax on their base salary, but actual liability will depend on marital status, total household income, deductions for interest payments on their home if you own it, the number of dependant children and other tax deductions, and tax credits allowed by federal income tax laws.

There are two options for paying in estimated federal withholding income tax:

- Withhold tax from paycheck
- Pay into the government quarterly (same as FICA)

State Income Tax Withholding: State income tax withholding is also based on salary only. Actual liability owed is computed in a similar manner as federal income tax, just at a lesser rate. Check with state website for up-to-date information.

Payment requirements differ from state to state.

Payment can be made through the regular payroll check withholding just like federal withholding.

Recommendations:

1) Get with a qualified, experienced tax accountant who has experience with clergy tax preparation for guidance.

2) Determine your estimated annual liabilities for:

- FICA (if applicable)
- Federal income tax
- State income tax

3) Determine the method of payment.

- Through payroll deductions
- Through quarterly payments

4) Follow through with payment method.